History shows that Greece is able to implement meaningful reform

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Greece is heading for another showdown with its creditors. With a major bond payment due in early July, expect another round of arguments on the need for structural reforms from the one side and the necessity of debt relief from the other; and rest assured that the creditors' preferred background tune "Grexit" will also be playing this summer, though less loudly than on previous occasions given Europe's need to co-operate with the country over the refugee crisis.

Greece's fundamental problem with monetary unions: past and present

What makes euro membership so difficult for Greece? Studying the first century of modern Greek monetary history from the foundation of the National Bank of Greece in 1841 to World War II shows striking parallels to the present: repeated cycles of entry into and exit from monetary unions (mainly the gold standard, the euro of its day), government debt build-up and default, and financial supervision by West European countries. The main problem was, not unlike today, balancing the budget. Rather than reforming taxation, persistent budget deficits were either monetised ("printing press") or financed through international bond markets. Both strategies came at a price. Strong reliance on the printing press made Greece's currency depreciate vis-à-vis the currencies of countries with balanced budgets, ending its coveted monetary union membership. Financing deficits through bonds also had its pitfalls: high levels of foreign debt eventually resulted in financial supervision, by which creditors took control of the country's finances, either following default (1898) or "pre-emptively" (1928: League of Nations loan-cum-conditionality agreement).

The role of foreign countries in making monetary union membership work

Financial supervision was not more popular at the time than it is today. Yet ironically, it was precisely the strong foreign involvement which cured the old diseases: budget surpluses began to emerge, the central bank became more independent and eventually the country was able to join the gold standard (in 1910 and 1928, respectively). Greece's economic policies were systematically different under financial supervision: simply put, "prudent" under

supervision and “lax” otherwise. Financial oversight was a blessing in disguise as it enabled the country to achieve its long-standing objective of exchange-rate stabilisation. The 1898-1914 experience is particularly instructive: Greece began collecting existing taxes more efficiently and introducing new ones that were standard practice elsewhere. For instance, it introduced inheritance tax and income tax, following decades of futile purely domestic reform attempts before.

Is the loss of sovereignty a price worth paying for monetary union membership? There are no clear answers, but the past entails important lessons for today. Most contemporaries would have answered “yes”: gold standard membership was sought for a combination of economic and political factors, with political considerations substantially more important than for other European countries. Membership of the gold club before World War I was seen as an important pillar of a much larger modernisation programme; eventually achieving this status in 1910 was celebrated as evidence of how much Greece had matured politically since independence (1832) and how much it had caught up economically with Britain, France and Germany as the leading European economies. The interwar political rationale for joining gold was no less powerful: currency stabilisation became closely linked to key political issues such as infrastructure projects, refugee relief, and political alliances. International funds would only flow, if Greece re-joined the gold standard and allowed foreign oversight of its finances; the country grudgingly accepted financial supervision for a second time.

Lessons for today

The long-run record of Greece suggests that lasting monetary union membership can only be achieved if the country’s finances are effectively constrained. The extensive monitoring by the IMF, the European Commission and the ECB since the first bail-out in 2010 corresponds closely to earlier experiences with monetary unions and can be seen as the country-specific way of making the euro work.

A second lesson relates to domestic attitudes: understandable public resentment against ‘foreign intrusion’ needs to be weighed carefully against its potential to secure the long-term political and economic objective of exchange-rate stabilisation. The high drama of summer 2015 – when the Greek electorate first rejected a referendum on the conditions attached to a third bailout, only for the Greek government to agree to more stringent conditions a week later – followed a well-established pattern: if forced to choose, Greece prefers monetary union membership and is willing to accept a high level of foreign interference. EMU membership enjoys extremely wide acceptance across the political spectrum; any politician openly contemplating the idea of leaving the euro during last year’s turbulent summer was evicted from parliament either by party-internal procedures or in the subsequent elections in September 2015.

This is explained by the importance which Greece has consistently attached to political factors behind monetary union membership. In the case of the euro, the weight of political compared to economic considerations has even increased over time, as many of the envisaged economic benefits have vanished (Greece has had zero growth under the euro: boom and bust have cancelled each other out). While such political motivations are somewhat diffuse by their nature (to remain part of an economically and politically more integrated euro area as an avant-garde group within the EU; or even the euro as a political status symbol), they have created a powerful narrative to stay within the euro essentially at any economic cost. The troika (European Commission, International Monetary Fund and European Central Bank) has ignored such political factors at its own peril: in underestimating its own bargaining position vis-à-vis Greece, the troika has all too often acquiesced into diluting structural reforms which would have helped the Greek economy. The first 100 years of modern Greek monetary history show that Greece is able to implement meaningful reform, but they also act as a reminder that external pressure is crucial in unlocking the reform potential. Greece and the troika would do well to remind themselves of the ambitious reform agenda they set themselves in 2010.

Notes:

- *This post is based on the authors' article Greece in a Monetary Union: Lessons from 100 years of exchange rate experience, presented in the 2016 Conference of the Economic History Society.*
- *The post gives the views of its author, not the position of LSE Business Review or the London School of Economics.*
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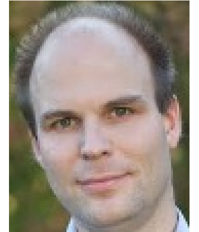

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